



JOHN CHIANG
California State Controller

January 31, 2012

The Honorable Mark Leno
California State Senate
State Capitol
Sacramento, CA 95814

The Honorable Bob Blumenfield
California State Assembly
State Capitol
Sacramento, CA 95814

Dear Senator Leno and Assemblyman Blumenfield:

I am writing in support of Senate Bill 95 and to commend members of the California State Legislature for quickly acting on this important legislation needed to avoid an approaching cash problem.

As State Controller, it is my responsibility to keep you informed of California's cash condition and to be a resource to you in ensuring that the State's payment obligations are met in a timely manner. My office has studied the Governor's recently-updated cash flow figures and has defined the magnitude and duration of the cash shortfall that we first brought to your attention in December 2011. If left unaddressed, the State's General Fund balance will fall below the \$2.5 billion minimum safety cushion on February 29. On the following day, cash will be exhausted and will continue to decline until hitting a low of -\$730 million on March 8. Notwithstanding several days at the end of March, this liquidity shortfall is projected to persist for a defined period of time – about seven weeks, from February 29 until approximately April 13.

Assuming no additional revenue loss, erosion of borrowable internal funds, or significant spikes in spending, \$3.3 billion of cash solutions are needed to address California's liquidity needs during this period. This figure includes a prudent amount to mitigate reasonable risks.

If you recall, the cash crises of 2009 compelled my office to utilize a variety of aggressive cash conservation measures to avoid defaulting on payments to schools, bondholders, and other legally-protected payees. Default, as you know, would have lowered California's

credit ratings to junk status and further de-stabilized our recession-torn economy. Fortunately, the circumstances surrounding the current cash shortfall are far different from those underlying the 2009 crises. In that year, the capital markets were closed to a traditional cash-flow borrowing without a complete budget overhaul and, due to the duration and magnitude of the shortfall, less intrusive cash management options would not have provided a sufficient amount of cash to make legally-required and protected payments.

I believe the upcoming shortfall can be effectively managed without resorting to IOUs, tax refund delays, and other drastic measures with SB 95 and other steps we must take – quickly and collaboratively – in the coming days.

Over the past week, my office, in close partnership with the Department of Finance and the Treasurer's Office, has produced a cash management plan using a combination of payment delays, some external borrowing for a limited period, and the use of additional internal borrowing authorized in SB 95.

Although this cash management plan relies on still more borrowing, payment delays and deferrals, we believe this is the most prudent and responsible course of action considering we have about four weeks before the advent of the cash shortfall. It is not an ideal solution, but it is the best way to manage the challenge without relying on IOUs or delaying tax refunds – actions that can disrupt the delivery of essential public services and slow California's economic recovery.

Given the nature of our cash position, the proposed \$3.3 billion solution is a measured course of action. Note, however, that more cash solutions may be required if our revenues continue to erode or if disbursements significantly exceed estimates.

The potential cash problem we face in the current year is linked to expenditures and receipts which are tracking differently from those projected when the 2011-12 Budget Act was enacted. As of December 31, 2011, total receipts are coming in \$2.6 billion less than forecasted, and expenditures are \$2.6 billion more than assumed. Together, both of these components translate into a \$5.2 billion reduction in cash resources. The deviation of actual cash amounts from the estimates has many roots, including:

- Limiting the size of the 2011-12 Revenue Anticipation Notes to a level unseen since 2006, in an attempt to lower borrowing costs by tens of millions of dollars;
- Overly-optimistic assumptions coupled with the difficulty in projecting revenues during times of economic uncertainty and high market volatility;
- The challenges of accurately predicting cost savings when implementing new programs and other large-scale changes such as realignment and the elimination of redevelopment agencies;
- Delays in federal decision-making, such as those involving California's requests for waivers from a variety of federal requirements; and
- Adverse court decisions.

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Again, I thank members of the California Legislature for their leadership on SB 95, and respectfully urge its quick approval.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

cc: The Honorable Bill Lockyer, California State Treasurer
Ana Matosantos, Director, Department of Finance
Mac Taylor, Legislative Analyst